

Message Text

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TO AMEMBASSY JAKARTA

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TAGS EFIN

SUBJ INDONESIAN-US TAX CONVENTION

RE JAKARTA 8065, 7674 & 7270 OF 1973 AND 12241 OF 1972; STATE 95091

1. TREASURY DEL TO AUG 8 MEETINGS WILL BE NATHAN GORDON, DEPUTY TO ASST SEC (INT'L TAX POLICY) AND ROBERT PATRICK, INT'L TAX COUNSEL. EMB PARTICIPATION WELCOME. PLEASE RESERVE TWO SINGLE HOTEL ROOMS AUG 8-10. ETA TO BE SENT LATER.

2. RE INDIVIDUAL TAX ON US EMPLOYEES, SEVERAL POSSIBLE APPROACHES WERE RAISED BY US DURING PRIOR SESSIONS WHICH WE WOULD LIKE TO GET GOI REACTION TO:

(A) ONE EXAMPLE IS A "VISITING EXPERT" PROVISION UNDER WHICH FOREIGN EMPLOYEES SENT BY FOREIGN FIRMS WOULD ENJOY A REBATE FROM INDONESIAN TAX ON THEIR REMUNERATION WHICH HAS THE EFFECT OF LIMITING THAT TAX TO WHAT THEY WOULD PAY IN THEIR HOME COUNTRY DURING A SPECIFIED PERIOD (SUCH AS FOUR YEARS) OF EMPLOYMENT IN INDONESIA. INDONESIA HAS USED THIS METHOD IN CONTRACTS WITH US COMPANIES. AUSTRALIA ALSO

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FOLLOWS THIS APPROACH.

(B) ANOTHER APPROACH, USED BY SEVERAL EUROPEAN COUNTRIES, IS TO ALLOW A SPECIAL DEDUCTION TO FOREIGN EMPLOYEES TO COVER THE ADDED COSTS OF FOREIGN RESIDENCE. A DEDUCTION OF 50 PERCENT OF THE GROSS SALARY WOULD SEEM NECESSARY TO ADJUST THE INDONESIAN AND US TAX LIABILITIES (LEAVING ASIDE THE \$20,000 US EXEMPTION OF FOREIGN EARNED INCOME) ON A SALARY OF \$20,000-\$30,000.

(C) AN ARTIFICIAL EXCHANGE RATE CAN ALSO BE USED TO TRANSLATE A SALARY PAID IN US DOLLARS INTO A LESSER AMOUNT OF LOCAL CURRENCY FOR TAX PURPOSES THAN WOULD RESULT FROM THE MARKET RATE OF EXCHANGE, BUT WE UNDERSTAND THAT THIS METHOD WAS USED BY INDONESIA AND HAS BEEN REJECTED AS UNSATISFACTORY.

(D) STILL ANOTHER METHOD OF DEALING WITH THIS SITUATION IS KNOWN AS THE "REMITTANCE" BASIS, WHEREBY FOREIGN EMPLOYEES WHO DO NOT INTEND TO BECOME PERMANENT RESIDENTS ARE TAXED ONLY ON THE PORTION OF THEIR SALARIES REMITTED TO (RECEIVED IN) THE HOST COUNTRY. THE UK USES THIS APPROACH.

(E) WE THINK A SATISFACTORY VARIATION ON THE REMITTANCE BASIS OF TAXATION WOULD BE TO PROVIDE THAT THE REMUNERATION PAID BY US FIRMS TO US EMPLOYEES IN INDONESIA WOULD BE SUBJECT TO INDONESIAN TAX TO THE EXTENT RECEIVED IN INDONESIA BUT ON NOT LESS THAN 50 PERCENT OF THE TOTAL SALARY PAID AND DEDUCTED BY THE US FIRM.

WE ARE PREPARED TO CONSIDER MODIFICATIONS OF THESE EXAMPLES OR NEW APPROACHES, AND OF COURSE WOULD HELP PREVENT ABUSES THROUGH EXCHANGES OF INFORMATION.

3. RE POINTS RAISED PARA 3 JAKARTA 7270, CANNOT NOW ADD MUCH TO EARLIER RESPONSES. NEED TO DISCUSS NATURE OF PROBLEM AND ALTERNATIVE SOLUTIONS. HOWEVER, SOME INITIAL THOUGHTS AS FOLLOWS, USING NUMERATION OF JAKARTA 7270.

A. IN ART 3 WE HAD AGREED AT GOI REQ TO DELETE REF TO CONTINENTAL SHELF SO 1(B) SIMPLY SAYS "THE TERM INDONESIA MEANS THE REPUBLIC OF INDONESIA" (P. 4 DATED AUG 28, 72). IF INDONESIANS ARE NOW LIMITED OFFICIAL USE

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RETURNING TO EARLIER DRAFT WHICH CONTAINS REFS TO CONTINENTAL SHELF WE WOULD PREFER THAT, BUT WOULD WANT TO ADD LANGUAGE ON EXPLOITATION OF SHELF, TO DISTINGUISH BETWEEN DRILLING ACTIVITIES (CONSIDERED TO TAKE PLACE WITHIN THE TERRITORY) AND FISHING (NOT CONSIDERED WITHIN THE TERRITORY BECAUSE THE SHELF ITSELF IS NOT BEING EXPLOITED).

B. USE OF WORD "SOLELY". SINCE WE AGREE IN SUBSTANCE WE SHOULD

BE ABLE TO WORK OUT A SOLUTION.

C. AGREED.

D. AGREED.

E. AGREED.

F. NEED TO DISCUSS FURTHER. WE WOULD AT LEAST WANT TO PROVIDE FOR RECIPROCAL EXEMPTION TO TAKE EFFECT WHEN AN INDONESIAN AIRLINE BEGINS FLIGHTS TO THE US, AND IN THE LOSS YEARS.

G. PARENTHETICAL SIMPLY CONFIRMS THAT US WILL TAX ITS CITIZENS WHEREVER RESIDENT (WITH A FOREIGN TAX CREDIT) AS ALSO STATED IN PARA 3 ART 27, PG 56.

H. WE AGREE IN SUBSTANCE AND WILL DISCUSS LANGUAGE. WILL BRING MATERIALS REQUESTED ON EXIM AND OPIC.

I. TO BE DISCUSSED FURTHER. A TAX OF 20 PERCENT ON GROSS PAYMENTS IS A VERY HIGH TAX ON NET INCOME FOR FILM COMPANIES, GIVEN THEIR TYPICAL PROFIT MARGIN, AND WOULD EXCEED THE US TAX.

J. WE FIND THAT THE OECD CONCEPT OF A "FIXED BASE" IS VAGUE AND LEAVES TOO MUCH DISCRETION TO ADMINISTRATORS. WE PREFER A TIME LIMIT AS A MORE DEFINITIVE CRITERION.

K. THIS REMAINS A PROBLEM FOR US, BUT WE UNDERSTAND GOI DIFFICULTY AND HOPE TO FIND AN ALTERNATIVE SOLUTION TO PRESENT DRAFT LANGUAGE.

4. WITH RESPECT TO ADMINISTRATION PROPOSALS ON ELIMINATING DEFERRAL IN TAX HOLIDAY SITUATIONS WILL DRAFT LANGUAGE, FOR POSSIBLE INCLUSION IN TREATY TO BE DISCUSSED DURING AUG SESSIONS.
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5. WE UNDERSTAND, ACCORDING TO JAKARTA 12241 OF NOV, 72 THAT SOME REDRAFTING OF ART 5, PARA 2(J) ALSO REQUESTED. OTHER CHANGES REQUESTED IN THAT REFTEL ACCEPTABLE UNLESS OTHERWISE INDICATED ABOVE.
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